United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-1596

ORIGINAL

To be argued by
CHARLES J. ACKER

United States Court of Appeals

For the Second Circuit

STUART D. WECHSLER, on behalf of himself and all others similarly situated,
Plaintiff-Appellant-Appellee,

against

SOUTHEASTERN PROPERTIES, INC.,
Defendant-Appellee-Appellant,

MONARCH FUNDING CORP., ANTHONY J. DEMATTEO, WILLIAM L. MANNING, JAMES HENRY, RONALD ULLENBERG, DAVID L. BOYD, H. T. BRADDOCK, GEORGE E. McGEE III and CHALMERS K. SMITH, and HENRY, McCORD, FORRESTER & RICHARDSON, EDITH COOPER, and SCHNEIDER & BARATTA,
Defendants-Appellees.

On Appeal from the United States District Court for the Southern District of New York

BRIEF OF DEFENDANTS-APPELLEES JAMES HENRY AND HENRY, McCORD, FORRESTER & RICHARDSON

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Preliminary Statement

Defendants-appellees James Henry and Henry, McCord, Forrester & Richardson (Henry defendants), were respec-

tively, secretary and general counsel to Southeastern Properties, Inc. (Southeastern), the issuer of the securities involved in this litigation. On this appeal the Henry defendants assert that plaintiff-appellant has not established any basis for an award of counsel fees because of services allegedly rendered in this action. The Henry defendants further contend that in no event can attorney fees be awarded as against them in litigation which has not been tried to a conclusion.

Questions Presented

1. Where a state Attorney General, on his own initiative, commences an investigation into a corporation's public offering of securities and suspends trading in such securities, which investigation ultimately results in a rescission of the public offering by the corporation, may a shareholder who commences a separate putative class action with knowledge of the Attorney General's investigation, recover counsel fees when the private action rendered moot by the rescission, was of no direct assistance to the Attorney General?

2. May an individual defendant, in an action under the federal securities laws, be assessed for the fees of plaintiff's counsel upon dismissal of the action without trial when the issues in the action are effectively mooted because of a settlement in a separate action to which this defendant was not a party and in no way participated?

The Facts

Plaintiff appeals from an order of the Honorable Whitman Knapp entered April 4, 1974 dismissing this action and denying his application for counsel fees and costs. At a hearing held before Judge Knapp on July 31, 1973, counsel for plaintiff agreed that this action ". . . should be dismissed . . ." (317a) and, indeed, his brief on this appeal states that plaintiff "appeals from so much of the order of the United States District Court for the Southern District of New York (Knapp, J.) as denied plaintiff's application for counsel fees and costs upon dismissal of this class action (345a)." Plaintiff apparently does not question Judge Knapp's implicit denial of class action status nor the dismissal of the action itself.

The Henry defendants were not named in the order of New York State Supreme Court, filed on September 12, 1972 (129a) which enjoined Southeastern from disposing of its assets and called for examinations before the court of Southeastern and various other individuals. Similarly, the Henry defendants were not named in the action thereafter commenced by the People of the State of New York against Southeastern, Anthony J. DeMatteo and William L. Manning (228a). This state action ultimately resulted in the consent injunction which was the basis for the tender offer and rescission which mooted the instant action (228a *et seq.*). The Henry defendants did not participate in any way in the state court settlement.

In this action there has been no trial, almost no discovery, no fund or benefit created for the company or the

stockholders and no opportunity for the Henry defendants to assert their factual and legal defenses. It is submitted that there is no legal or equitable basis to hold the Henry defendants in any way responsible for the fees of plaintiff's counsel, should they be awarded.

The opinion of Judge Knapp, dated April 4, 1974 (349a) insofar as it held that "this action was initiated by plaintiff without knowledge—and independently of—the Attorney General's investigation" was in error. Plaintiff's original complaint, dated May 2, 1974 (not contained in the appendix), refers to the Attorney General's investigation (¶17) as does the amended complaint (¶18) (10a).

The lower court also found (1) that the Attorney General's investigation was instituted prior to any action by plaintiff or his counsel; (2) that the Attorney General's action grew out of his own investigation and its initiation was in no way induced by any activity by plaintiff or his counsel; and (3) that "[w]hile the pendency of this action may have made the defendant Southeastern more amenable to settle with the Attorney General, I am not persuaded that plaintiff or his attorney was of any direct assistance to the Attorney General" (351a).

POINT I

The record is devoid of any basis to support a fee award to plaintiff's counsel.

When the instant action was commenced, the New York Attorney General had already begun his investigation and had suspended the trading of Southeastern's stock in this state (10a). Plaintiff does not assert that he was in possession at any time of any evidence not known to the Attorney General, so as to be of real assistance to the State.

This Court in *Grace* v. *Ludwig,* 484 F.2d 1262 (2d Cir. 1973), cert. denied 40 L. Ed. 2d 110 stated:

> "At the heart of the doctrine favoring the award of counsel fees in securities cases is the need to encourage the vigilance of private attorneys general to provide corporate therapy protecting the public investor who might otherwise be victimized" (p. 1267).

This court then discussed the value of such private litigation scrutiny in situations where the SEC could not independently verify material such as proxy statements submitted to it. But, this court found in *Grace,* that the action of the SEC under §17(a) of the Investment Company Act, was not a simple reporting function, or the pro forma or perfunctory review of written material. The SEC under this statute could issue an order for exemption only if the proposed transaction met certain standards, and then only after a hearing. *Grace, supra,* at 1268. This Court, in such circumstances, saw no basis for approving the compensation of the intervenors' attorneys where the SEC's scrutiny was more than ministerial or casual and plaintiff had

failed to show that "but for" the intervention of his counsel, the SEC would have failed in its duty.

Plaintiff emphasizes an alleged distinction between the instant case and *Grace* in that the SEC in *Grace* had a special responsibility to issue an order for exemption under the Investment Company Act. In fact, the Attorney General's action in this case in actively pursuing its investigation of Southeastern directly parallels that of the SEC's responsibility in issuing an order for exemption under the Investment Company Act. The Attorney General's investigation was obviously more than perfunctory or pro forma.

The Attorney General here had a statutory responsibility under New York General Business Law §352 to insure compliance with New York law and presumably had the expertise to carry out his responsibility. To permit a private litigant to recover counsel fees in an action commenced after the state investigation was begun, and where the private litigant did not contribute to "corporate therapeutics" by disclosing undetected fraud, brings into focus the very policy considerations which this Court set forth in *Grace*. The court there stated:

> "Aside from the lack of special circumstances calling for the intervention of a private attorney general as well as the difficulty of assessing the value of the putative benefit here, we would face the impossible task of attempting to measure the value of the service of the intervenor. A precedent here would encourage intervention in comparable cases not only before the SEC but other agencies as well. The competition and maneuvering among counsel to assume the lead role would not only be disruptive of administrative procedures but might very well encourage agency inaction. . . . The introduction of additional cooks might not

> only spoil the broth but paralyze the chef. See Casey v. Woodruff, 49 N.Y.S.2d 625, 648 (Sup. Ct. 1944). A district court would be hard put to determine the value of the contributions of each in a subsequent action far removed from the agency proceeding'' (p. 1271).

Plaintiff contends that Southeastern delayed its rescission offer and interposed answers to the complaint in this action when "it is clear that there was almost certainly a violation of the Securities Act of 1933 and the Securities Exchange Act of 1934" (Plaintiff's Brief, p. 12). The contention seems to be that such conduct deterred the vindication of clear claims and caused great expense because of Southeastern's obdurate conduct. Plaintiff stresses that the rescission would not have occurred unless liability was clear (Plaintiff's Brief, p. 5).

However, Southeastern's counsel has strenuously refused to concede liability (333a). As this court said in *City of Detroit* v. *Grinnell Corporation*, 495 F.2d 448 (2d Cir. 1974):

> "It cannot be overemphasized that neither the trial court in approving the settlement nor this court in reviewing that approval have the right or the duty to reach any ultimate conclusions on the issues of fact and law which underlie the merits of the dispute" (p. 456).

It is submitted that plaintiff has not established that this case required the services of an additional cook.

POINT II

Under no circumstances may attorneys' fees be awarded as against the Henry defendants.

In *Hall* v. *Cole*, 412 U.S. 1 (1973), the Supreme Court restated the rule that in American jurisprudence a successful litigant may not recoup his counsel fees absent the existence of special circumstances. The Court there held that such fees may be awarded to a successful party when his opponent has acted "in bad faith, vexatiously, wantonly or for oppressive reasons." *Hall, supra,* at 5. In the instant case there is neither indication nor allegation that the Henry defendants have acted in any such manner. Another special circumstance exists when the plaintiff in successful litigation has conferred substantial benefit on members of an ascertainable class. See *Mills* v. *Electric Auto-Lite Co.,* 396 U.S. 375 at 393-94 (1970).

In *Sprague* v. *Ticonic National Bank,* 307 U.S. 161 (1939), the Supreme Court held that the award of attorney fees in special circumstances cases are within the Court's equitable power when plaintiff has obtained a judgment which creates a common fund for the benefit of an ascertainable class. In *Sprague,* the Court indicated that to allow other beneficiaries to obtain benefit from the plaintiff's efforts without requiring a contribution or charging of the common fund for attorney fees would unjustly enrich the others at the cost of the plaintiff. The same concept was reiterated in *Grace, supra,* at 1269 wherein this Court held that the equitable basis for fees in special circumstances is the prevention of unjust enrichment.

In cases where the plaintiff creates a fund or benefit so as to fall within the special circumstances rule, the fee award is from the fund, *Hall* v. *Cole, supra,* at 5 n. 7, and not from the adverse parties, *Ballwanz* v. *Jarka Corp. of Baltimore,* 382 F.2d 433 (4th Cir. 1967). Thus, in *Mills* v. *Electric Auto-Lite Co., supra,* the Court held that plaintiff shareholders who established a violation of the securities laws by their corporation and its officials should be reimbursed by the corporation. The Court stated:

> ". . . regardless of the relief granted, private stockholders' actions of this sort 'involve corporate therapeutics,' and furnish a benefit to all shareholders by providing an important means of enforcement of the proxy statute. To award attorneys' fees in such a suit to a plaintiff who has succeeded in establishing a cause of action is not to saddle the unsuccessful party with the expenses but to impose them on the class that has benefited from them and that would have had to pay them had it brought the suit." *Id.* at 396-97.

In the instant action, the Henry defendants are neither beneficiaries of the Attorney General's action nor of this action. They played no role in the settlement of the state action and have had no opportunity to defend themselves in this action.

It is submitted that no basis exists for an award of counsel fees as against the Henry defendants.

Conclusion

There is no basis for an award of counsel fees to plaintiff as against the Henry defendants. The opinion of the lower court should be affirmed.

Respectfully submitted,

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